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Suit Prompted by Failure of Bahamas Bank Puts Accounting Industry Practice on Trial

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If the law firm of Williams & Connolly has its way, there could be significant changes in how the accounting profession conducts its business.

In a suit filed in federal district court in Washington that attempts to fix the blame for a Bahamian bank collapse, Williams & Connolly argues that Price Waterhouse & Co., the nation's largest accounting firm, should be held liable for the acts of a Bahamian affiliate.

In response, lawyers for Price Waterhouse maintain that each of the organization's affiliate offices is "independent." But Williams & Connolly already has started chipping away at that defense. A federal judge has ruled that secret "audit standard reviews," Price Waterhouse's internal audits of its affiliates, must be turned over to Williams & Connolly.

The CIA Connection?

Attorneys for five of the Big Eight accounting concerns argued unsuccessfully that disclosure of the reports would practically destroy the effectiveness of the accounting profession. They say they haven't decided whether to appeal.

Meanwhile, there are indications that an accountant for Price Waterhouse's Bahamian affiliate may have had connections with the Central Intelligence Agency. Price Waterhouse denies any involvement.

In the court battle, Williams & Connolly represents the liquidators of Mercantile Bank & Trust Co., Freeport, the Bahamas. In 1973, a two-thirds interest in Mercantile was purchased by International Bank of Washington, a diversified holding company. International bought its stake from Mercantile's largest shareholder, a Panamanian concern controlled by E. Gordon Mosvold, a member of a Norwegian shipping family.

"Largely Worthless" Loans

According to documents filed in the suit, auditors for International discovered in 1976 that practically all of Mercantile's assets (mostly outstanding loans) were "largely worthless."

Price Waterhouse's Freeport office had been Mercantile's outside auditor since the bank was formed in 1962. Shortly after the discovery by International's auditors, Price Waterhouse withdrew its unqualified opinion of Mercantile's financial statements, according to Price Waterhouse documents. In 1977, court records in the Bahamas show, the Bahamian government suspended Mercantile's license and put the bank into liquidation.

As a result of Mercantile's insolvency, International says it sustained about \$9 million in damages, \$5.7 million of which was charged against previous years' earnings. International sued Price Waterhouse and Mercantile's previous owners and directors, accusing them of fraud.

Later, Mercantile's liquidators in the Bahamas filed a similar suit in federal court in Washington. The liquidators, Dennis Cross and David Hamilton (who are accountants for the Nassau office of Peat, Marwick, Mitchell & Co.), also allege that International was part of the conspiracy. International denies the charge.

According to the liquidators' suit, Mercantile's problems began when Mr. Mosvold and others caused the bank to lend several million dollars to unidentified "American investors" for stock-market purchases. When Mercantile called the loans due after the stock market took a "precipitous plunge," the suit says, the borrowers refused to pay. Mr. Mosvold has denied the allegations.

To hide the bad loans, the suit says, Mercantile officials created shell companies to "buy" the loans. The practice allegedly continued until International's auditors uncovered it. A liquidators' report in August 1977 said Mercantile's liabilities were \$27.5 million and its assets were \$25.1 million, of which \$20.7 million consisted of alleged sham loans.

The suit also contends that Price Waterhouse's Freeport office declared Mercantile to be "sound" after its usual audit and after a "special" audit in 1977 in connection with the sale to International. The accounting office's actions were "clearly reckless, wanton and willful" misconduct, the suit charges.

In response, Price Waterhouse's New York headquarters says all Price Waterhouse affiliates are "independent" partners and the accounting firm "has no responsibility for any of the acts" of its Bahamian affiliate. Lawyers for the liquidators hope to show, however, that Price Waterhouse is "a single international business entity." They cite a Price Waterhouse recruiting brochure that describes the firm as "a global organization."

The liquidators also are pressing to obtain Price Waterhouse's "audit standard reviews" of the Bahamian affiliate prepared in 1971, 1974 and 1976. Price Waterhouse officials in New York describe the reviews as internal audits conducted periodically to insure compliance with policies and standards.

Trying to prevent disclosure of the reports, Price Waterhouse marshalled the support of four other Big Eight accounting firms and some former Securities and Exchange Commission officials. Release of the

confidential reports, according to affidavits filed in court, would be "mischief" at best and, at worst, "would break down" the accounting process "around the world," thus becoming detrimental to "the public interest."

Among those supporting this argument were Peat, Marwick, Mitchell & Co., Touche-Ross & Co., Arthur Young & Co., Ernst & Whinney, and John C. Burton, former chief accountant for the SEC.

A federal judge in Washington who studied the affidavits and listened to the arguments recently decided they were "self-serving." He ordered Price Waterhouse to turn over the contested reports to Williams & Connolly, lawyers for the liquidators.

In its defense, Price Waterhouse argued strenuously that the reviews don't "mention Mercantile in any way" and don't "contain any evaluation of the Mercantile audits."

Why? Price Waterhouse won't elaborate. But a former CIA official says "certain persons" were "under orders" to make sure "outsiders" didn't get access to Mercantile's books. If they poked around, he says, they "could unravel a trail to the intelligence community."

The official says Mercantile "had performed some functions" for the CIA before International purchased control of the bank. He declines to say what those functions were.

The official also says E. R. Fingland, the senior managing partner of Price Waterhouse's Freeport office until 1970, was the person the CIA dealt with. "Mercantile's books were specially handled," the former official says.

After leaving Price Waterhouse, Mr. Fingland became a director of Mercantile. The liquidators' lawsuit alleges that, during that time, Mr. Fingland "actively" participated in the accounting firm's business. In court filings, Mr. Fingland and Price Waterhouse have denied any wrongdoing.

According to several intelligence community sources, Mercantile was a frequent conduit for CIA money, mostly in the 1960s but also until several months before International's purchase. From its inception in 1962 until its collapse in 1977, Mercantile shared most common directors and shareholders and had transactions with Castle Bank & Trust Co., a Nassau bank that is defunct. As reported earlier in this newspaper, Castle was controlled by the CIA. The same group of directors and shareholders operated three other Caribbean banks, which the CIA reportedly used to launder money.

A CIA spokesman says his agency never comments on such allegations.

Lawyers for the liquidators say they plan a suit against the CIA because the agency hasn't released documents about Mercantile